

FIGURE
OF THE WEEK

-0.5bps

This week's
cut in India's
repo rate (to
6.75%)

In the Headlines



India: Pulling the trigger?

On Tuesday, the Reserve Bank of India announced a large cut in the repo rate, to 6.75% from 7.25%. Inflationary pressures have declined significantly in relation to the official target (6% or below in January 2016), with CPI inflation at 3.7% y/y in July and August. The economic outlook is subject to cyclical headwinds, including weaker growth in external demand and in investment (+4.9% y/y in Q2 2015). Monetary policy has eased significantly since the beginning of the year (-75bps from January to August) but has not translated into strong growth in credit; domestic bank credit increased by around +9% y/y between January and September compared with +12.4% in 2014. The latest rate cut comes at a time when external fundamentals have improved: lower current account deficit, lower currency risk and improved credibility of economic management. The rate cut was accompanied by regulatory changes to encourage foreign investment, with easier access to government bonds. In addition to the boost to investment through credit, such changes will strengthen investor confidence. We expect GDP growth will accelerate over the next quarters, pushing overall expansion to +7.7% in FY2015/16.



U.S.: Consumer strength, Fed likely to move in December

Q2 GDP growth was revised upwards to +3.9% q/q annualised (from +3.7%), driven by non-residential business investment (+5.1%), residential investment (+9.4%) and robust consumption (+3.6%). Real personal consumption continued to grow in July and gained +0.4% m/m in August as disposable incomes increased by +0.3%, boding well for Q3. In addition, consumer confidence improved by another +1.8 points in September, after +10.8 in August. The present situation index improved +5.3 to 121.1, the highest in eight years. Meanwhile, consumer price inflation remains dormant at 0.3% y/y, while the core inflation rate remains at 1.3%. However, inventories increased in H1 at the fastest pace on record, likely tempering Q3 consumption gains. Housing data were mixed as new home sales gained +5.2% m/m in August, the highest level of the recovery, but prices of existing homes fell -0.2% m/m for the third consecutive month. Fed Chair Janet Yellen and two other Fed voting members gave speeches strongly suggesting a rate hike in 2015, which Euler Hermes expects in December.



Eurozone: More ECB stimulus is likely by year-end

Inflation fell back into negative territory in September (-0.1% y/y) for the first time since April 2014. The fall was mainly driven by the decline in energy prices (oil prices down -16% in July, which is equivalent to -0.3pps from the inflation rate over the following 2-3 months). Excluding energy, food and tobacco, inflation remained stable and at a low level (0.9% y/y). Looking at the data already available, consumer prices in Spain (-0.9% y/y) and Germany (0% y/y) subtracted -0.1pps from overall Eurozone inflation. There were slight increases in Italy (+0.1pps to 0.3%) and Belgium (+0.2pps to 1.1%). We believe the probability that the ECB will expand its QE programme beyond September 2016, most likely until mid-2017, has increased and that the magnitude of the monthly asset purchases will increase from EUR60 bn. Indeed, bank interest rates on company loans are falling, but the recent EUR appreciation is limiting the potential for further improvements in financing conditions. Moreover, lack of demand remains a constraint for company investment and limits company credit demand (+0.4% y/y in August).



France: Against all the odds, France is back

In September, business confidence in the industrial sector improved to 104 (from 103), reaching its highest level since August 2011. As such, it corroborates the large increase (2.1pts) in this month's manufacturing PMI. Forward-looking components reached four-year highs. Business confidence in the retail sector again improved, gaining 2pts to 109. In the services sector, confidence fell back -2pts to 97 and it has not crossed the 100-threshold since August 2011. Meanwhile, after five months at a standstill, the consumer confidence index improved by 3pts to 97, its highest since October 2007. The improvement was broad-based but particularly notable was the 4pts gained in the "major purchases intentions" index. This is probably linked to declining fears about unemployment; the corresponding balance decreased (for the 2nd consecutive month) by 6pts, although remaining above its long-term average. The surveys underpin our GDP growth forecast of +1.2% in 2015. To do so requires growth of around +0.4% q/q (the current trend) for the next two quarters.

Countries in Focus

Americas



Costa Rica: Tax reforms remain elusive

Balancing public financing needs is challenging against a background of reduced export earnings (-16% y/y in H1) adversely affected by the closure last year of a microprocessor assembly and manufacturing plant. There is cross-party agreement that tax reforms are needed but policy implementation is difficult to achieve. Accordingly, external assistance is being sought: negotiations are underway for financial support from China; talks are continuing with the IADB and World Bank for a USD1bn contingency fund; and the local authorities may also seek bond issuance of a further USD1bn. Relations with China are already close, with that country currently constructing a highway from the capital to a container port at Puerto Moin, which could double the capacity of the world's leading exporter of pineapples. Expect a fiscal deficit equivalent to over -6% of GDP this year. Official plans to cut the deficit by -3.5pps in the next 2-3 years appear challenging as annual GDP growth is likely to be capped at around +3.5%.

Europe



Germany: Economic sentiment has peaked but remains solid

The Ifo Business Climate Index edged up to 108.5 in September (from 108.4 in August). While the current situation component fell to 114.0 (from 114.8) the expectation component climbed to 103.3 (from 102.2). This conflicts with the decline in September of the headline ZEW Economic Sentiment Expectations Index to 12.1 (from 25.0) while the ZEW Present Sentiment Index picked up to 67.5 (from 65.7). The GfK Consumer Climate Indicator edged down to 9.9 in September (from 10.1 in August) and is forecast to fall further, to 9.6 in October, indicating that consumer sentiment has passed its peak, although it remains markedly above the long-term average (GfK 5.3 since 2001). Meanwhile, the manufacturing PMI fell to 52.5 in September (from 53.3) but remained above the 50.0-threshold indicating expansion. Looking at quarterly averages, the headline Indexes are all above their levels a year ago and continue to support the EH forecasts of +1.6% real GDP growth in 2015 and +1.7% in 2016.

Africa & Middle East



Ghana: Help at hand

Q2 GDP increased by +3.9% y/y, following +4.1% in Q1 and +2.6% in Q2 2014, driven by the services sector and, in particular, by finance and insurance. The official forecast for GDP growth in 2015 as a whole is now +4.1%. External financial support is forthcoming, which is testament to Ghana's good track record of governance and compliance under previous support packages. In April, the IMF approved a three-year Extended Credit Facility of USD918mn. The World Bank is also providing substantial assistance and, in July, it approved a USD500mn IDA payment guarantee involving gas purchases from the offshore Sankofa Gas project and a USD200mn "Enclave Loan" guarantee by the IBRD. Additionally, this year, Ghana plans to issue around USD1.5bn in eurobonds, an offering that will receive a partial guarantee (first-loss cover on USD400mn of exposure) by the IDA. Business conditions in the short-term remain challenging but we expect a rebound in GDP growth to around +6% in 2016.

Asia Pacific



China: Renewed pressures on industrial profits

In January-August, industrial profits deteriorated (-1.9% y/y, -8.8% in August). Metals, mining and fuels continue to face cyclical headwinds, with lower commodity prices and weak demand externally and from domestic industries (including construction). Profits declined substantially in industries related to oil and natural gas extraction (-67.3% y/y) and those involved in the processing of ferrous metals (-51.6% y/y). Some sectors higher in the value chain and that are specific government targets are more resilient, including high-tech, chemicals and selected commodity processing. Profits increased rapidly in petroleum, coking and nuclear fuel processing industries (+50.5% y/y) and remained strong in electronics (+13.9% y/y for electronic and telecom equipment) and chemical products (+12.1% y/y). Downside risks remain elevated; consumer demand is growing only moderately and industrial demand will remain low, reflecting weak new orders (domestically and externally) and overcapacity.



What to watch

- October 1 – China September PMI
- October 1 – Spain, UK & France Sept. manufg. PMI
- October 1 – U.S. September ISM manufacturing index
- October 1 – South Africa August electricity output
- October 2 – Japan August unemployment
- October 2 – UK September construction PMI
- October 2 – U.S. September employment report
- October 5 – U.S. 5 Fed officials give speeches
- October 5 – U.S. September ISM non-manufacturing
- October 5 – Russia & Turkey September CPI
- October 5 – UAE & Saudi Arabia September PMI
- October 6 – Ukraine September CPI
- October 6 – Poland interest rate decision
- October 6 – Germany September construction PMI
- October 6 – Germany September factory orders
- October 6 – U.S. August international trade
- October 7 – Germany August industrial production

DISCLAIMER

These assessments are, as always, subject to the disclaimer provided below.

This material is published by Euler Hermes SA, a Company of Allianz, for information purposes only and should not be regarded as providing any specific advice. Recipients should make their own independent evaluation of this information and no action should be taken, solely relying on it. This material should not be reproduced or disclosed without our consent. It is not intended for distribution in any jurisdiction in which this would be prohibited. Whilst this information is believed to be reliable, it has not been independently verified by Euler Hermes and Euler Hermes makes no representation or warranty (express or implied) of any kind, as regards the accuracy or completeness of this information, nor does it accept any responsibility or liability for any loss or damage arising in any way from any use made of or reliance placed on, this information. Unless otherwise stated, any views, forecasts, or estimates are solely those of the Euler Hermes Economics Department, as of this date and are subject to change without notice. Euler Hermes SA is authorised and regulated by the Financial Markets Authority of France.

© Copyright 2015 Euler Hermes. All rights reserved.